**Internal Revenue Service**

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Person To Contact:
, ID No.

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Date:
February 20, 2013

LEGEND:

Taxpayer:
Company A:
Company B:

Company C:
Company D:
Company E:
Company F:
City a:
City b:
State a:
State b:
Date a:
Date b:
Date c:
Process:
Location a:
Location b:
Coal Seam Area:
Facility:
Power Plant:
Generator:

Dear :

This is in response to your request for rulings, submitted by your authorized representative, concerning the federal income tax consequences of the transaction described below:

FACTS

A. Taxpayer Information

Taxpayer is a State a limited liability company that is a wholly owned subsidiary of Company A. Taxpayer was formed to lease and operate two refined coal production facilities, including Facility. Because Taxpayer has not elected to be a classified as an association taxable as a corporation for federal income tax purposes, it is disregarded as an entity separate from Company A for such purposes. Company A is a State a corporation that is wholly owned by Company B. Company B, a State a corporation, is the common parent of a consolidated group of companies whose members include Company A.

B. The Refined Coal Production Process

1. The Facility

Taxpayer has leased the refined coal production facility (Facility) from Company D for a term ending on Date a. Company D is wholly owned by Company C. Facility was designed and constructed by Company C to produce a refined coal product that reduces emissions of nitrous oxide ($NO_x$) and mercury (Hg) when burned as a fuel in a coal-fired power plant.

Facility was placed in service in Date b, and is currently located at Power Plant located in City a, State b on land licensed to Taxpayer pursuant to an agreement with Generator, the owner of Power Plant. Power Plant is a coal-fired steam-producing power plant in regular commercial operation. Taxpayer has entered into a contract with Utility for the sale of refined coal produced by Facility to Utility for use as feedstock in Power Plant. Facility can be moved and reassembled at other power plant locations.

2. The Process

The technology employed to produce the refined coal in Facility is known as Process. It is a proprietary process which is designed to reduce $NO_x$ and Hg emissions in cyclone coal-fired boilers. The rights to the technology are licensed by Company E to

Company C, and have been sublicensed from Company C to Taxpayer for the full term of the lease of Facility. Company E and Company F formed company C to develop refined coal facilities. Company A then acquired an interest in Company C as a limited partner.

Process involves the use of two separate inorganic chemicals (Chemical Reagents) which are applied to the coal feedstock. The first Chemical Reagent is a solid material. It mixes evenly with the coal's native ash in power plant boilers and affects the melting properties of the coal's native ash during combustion in power plant boilers. This allows adjustment of the air-fuel ratio in the boiler which reduces oxygen in the boiler and provides more favorable conditions for reduction of $NO_x$ emissions.

The second Chemical Reagent is an inorganic liquid solution which reacts with the mercury in coal, resulting in changes to the chemical form of the mercury, oxidizing more of it. As a result, more of the mercury is captured with the fly-ash in the particulate control equipment, resulting in a higher degree of removal.

Facility's equipment transports the Chemical Reagents to a coal conveyor belt, where they are applied evenly to the coal feedstock. The Chemical Reagents are combined with the coal at a rate proportional to the coal flow rate. The application of each Chemical Reagent is controlled separately by computer equipment which determines the rate of application based on the flow rate of the coal on the conveyor belt. The proportion of each Chemical Reagent to be applied per ton of coal is set based on previously verified emissions test results.

*3.* Use of Blended Coal Feedstock

The Power Plant currently burns a blend of sub-bituminous coal and bituminous coal (Blended Coal). The sub-bituminous coal burned in the Power Plant is obtained from mines in various located in Location a. The bituminous coal burned in the Power Plant is obtained from various coal seams located in Location b. For the reasons described below, the exact ratio of Location a coal to Location b coal in the Blended Coal may vary on a day-to-day basis. The Power Plant typically burns coal in its boilers with a target blend of % Location a coal and % Location b (the Regular Blend). However, the Power Plant on occasion may need to burn Blended Coal using a ratio of Location a coal to Location b coal that is different from the ratio used in the Regular Blend, generally in order to satisfy load requirements or to clean slag buildup in the boilers.

In order to deliver refined coal which satisfies the Power Plant's specifications, Taxpayer intends to produce refined coal using Blended Coal composed of Location a coal and Location b coal obtained from the same sources that the Utility currently uses to obtain its coal. The ratio of Location a coal to Location b coal in the Blended Coal will vary as a result of two factors. First, although Taxpayer will most often produce refined

coal using Regular Blend feedstock, it may vary the ratio to satisfy the differing needs of the Power Plant. Second, while the coal feeders will be set to feed Location a coal and Location b coal at a predetermined ratio, the feeders are not precision instruments and there will be some variation in the ratio of Location a coal to Location b coal in the short term. Nevertheless, the ratio of Location a coal to Location b coal in the Blended Coal used by taxpayer as feedstock coal for the Facility will remain within a pre-determined, specified range (Blend Range). It is anticipated that the upper boundary of the Blend Range will be a Blended Coal containing % Location a coal and % Location b coal and that the lower boundary of the Blend Range will be a Blended Coal containing % Location a coal and % Location b coal.

4. Emissions Testing

a. Prior CEMS Field Testing

On Date c Company C conducted full-scale emissions tests, using continuous emission monitoring systems (CEMS) field testing conducted at Power Plant in accordance with the requirements of section 6.03(1) of Notice 2010-54 using the Regular Blend, which is the blend most commonly burned at Power Plant and refined coal produced at Facility from the Regular Blend. The emissions tests were conducted in the following manner: To establish a baseline for $NO_x$ and mercury emissions, one unit of Power Plant was operated for a three-hour period at or above % of full load using Location coal feedstock. The same Power Plant unit was operated for a second three-hour period under the same operating conditions (except for adjustments to primary or secondary air in accordance with good air pollution control practices), using refined coal produced in the Facility using the process from the Regular Blend and the Chemical Reagents, applied at a predetermined proportion.

During both the baseline test and the test using refined coal, $NO_x$ and mercury emissions were measured using CEMS equipment that conforms to applicable United States EPA standards. The $NO_x$ CEMS device was located upstream of the scrubber and the electrostatic precipitator, which controls particulate emissions. No post-combustion $NO_x$ emission controls were operational at the Power Plant during the testing period. The mercury CEMS device was located in the stack downstream of the particulate control equipment and the scrubber, which were operated under the same conditions throughout the testing period. The CEMS field testing demonstrated a reduction in excess of % of $NO_x$ released and a reduction in excess of % of mercury released when burning refined coal produced in the Facility from the Regular Blend compared to the emissions when burning the Regular Blend to produce the same amount of useful thermal energy.

The emission reductions demonstrated in each CEMS field test have been verified by an independent licensed professional engineer experienced in combustion and environmental engineering, as required by Notice 2010-54.

b. Emission Testing to Establish a Blend Range

Taxpayer anticipates that it will continue to use CEMS field testing to determine and redetermine the qualified emission reduction from burning refined coal produced in the Facility. In general, Taxpayer anticipates that it will conduct a single CEMS field test every six months using refined coal produced from Blended Coal (Test Blend) containing % Location a coal and % Location b coal. However, it may decide to conduct emissions testing using refined coal produced from Blended Coal with a lower percentage of Location a coal. Taxpayer will treat Blended Coals as comparable coal if the percentage of Location a coal in the Blended Coal is within 5 percentage points of the percentage of Location a coal in the Test Blend (Test Blend Range). For example, if Taxpayer conducts emissions testing using a Set Blend containing % Location a coal and % location b coal, Blended Coals containing between % Location a coal and % Location b coal will be treated as comparable coals. If Taxpayer decides to begin producing refined coal from Blended Coal that is outside the Test Blend Range, Taxpayer will conduct additional CEMS field testing.

In determining whether the percentage of Location a coal and Location b coal in the Blended Coal is within 5 percentage points of the percentage in the Test Blend, Taxpayer will determine the average blend range of Blended Coal used to produce refined coal over a period of up to six months since the most recent determination test or redetermination test. If the percentage of Location a coal and the percentage of Location b coal in the average blend over that period does not vary by more than 5 percentage points up or down (for a total of 10 percentage points) from the percentage of Location a coal and the percentage of Location b coal in the Test Blend, Taxpayer will treat the Blended Coals as comparable coals, and no redetermination testing will be required under the end of the six-month period

c. Redetermination Testing

Taxpayer will conduct redetermination testing using CEMS field testing or another method permitted by Notice 2010-54 on or before the first to occur of: (i) the expiration of six months since the last determination or redetermination testing conducted using a Test Blend; or (ii) if the Process is changed; however, it does not intend to conduct redetermination testing before increasing the Chemical Reagent application rate. In addition, Taxpayer will conduct redetermination testing in the event of a change in the source or rank of the coal used to produce refined coal at the Facility, including a change in the source of either the sub-bituminous coal or the bituminous coal comprising the Blended Coal or a change in the desired Blend Range. For example, if then-effective emissions testing conforming to the requirements of Notice

2010-54 was conducted using a Set Blend consisting of 95% Location a coal and 5% Location b coal, Taxpayer will conduct additional emissions testing if it decides to produce refined coal using Blended Coal containing less than 90% Location a coal.

RULINGS REQUESTED

Based on the foregoing, Taxpayer has requested that we rule as follows:

(1) Refined coal produced at the Facility using the Process and the Chemical Reagents is "refined coal" within the meaning of § 45(c)(7) of the Internal Revenue Code, provided the refined coal (i) is sold to an unrelated person within the meaning of § 45(c)(7) and (ii) meets the emission reduction requirement of § 45(c)(7)(B).

(2) An increase in the rate of application of a Chemical Reagent per ton of feedstock coal refined is not considered a "change in the process of producing refined coal from feedstock coal" for purposes of section 6.04 of Notice 2010-54.

(3) The lease of the Facility subsequent to its placed-in-service date will not affect the placed-in-service date of the Facility for purposes of § 45 of the Code and will not affect the determination of whether the lessee is eligible for production tax credits for refined coal produced at the Facility.

(4) If the Facility was "placed in service" prior to January 1, 2012 within the meaning of § 45(d)(8)(B) of the Code, a subsequent modification or relocation of the Facility will not result in a new placed-in-service date for that Facility for purposes of § 45, provided the fair market value of the original property of the Facility is more than 20 percent of the Facility's total fair market value at that time.

(5) All feedstock coals that are Blended Coals with a Location a coal content of +/-5% of the Location a coal content of a Test Blend shall be treated as feedstock coal of the same source and rank as the Test Blend for purposes of section 6.04 of Notice 2010-54 regardless of the mine from which such feedstock coal is purchased.

LAW AND ANALYSIS

Section 45(a) of the Code generally provides a credit against federal income tax for the use of renewable or alternative resources to produce electricity or fuel for the generation of steam. Section 45(e)(8) of the Code provides that, in the case of a producer of "refined coal", the credit available under § 45(a) of the Code for any taxable year shall be increased by an amount equal to $4.375 per ton of qualified "refined coal" (i) produced by the taxpayer at a "refined coal production facility" during the 10-year period beginning on the date that the facility was originally placed in service, and which

is (ii) sold by the taxpayer to an unrelated person during such 10-year period and such taxable year.

For purposes of § 45 of the Code, section 3.01 of the Notice provides that the term "refined coal" means a fuel which -- (i) is a liquid, gaseous, or solid fuel (including feedstock coal mixed with an additive or additives) produced from coal (including lignite) or high carbon fly ash, including such fuel used as a feedstock, (ii) is sold by the taxpayer with the reasonable expectation that it will be used for purpose of producing steam, and (iii) is certified by the taxpayer as resulting (when used in the production of steam) in a qualified emission reduction. Section 45(c)(7) and section 3.04 of the Notice provide that the term "qualified emission reduction" means (1) in the case of refined coal produced at a facility placed in service after December 31, 2008, a reduction of at least twenty percent (20%) of the emissions of nitrogen oxide and at least 40% of the emissions of either sulfur dioxide or mercury released when burning the refined coal (excluding any dilution caused by materials combined or added during the production process), as compared to the emissions released when burning the feedstock coal or comparable coal predominantly available in the marketplace as of January 1, 2003; in the case of production at a facility placed in service before January 1, 2009, a reduction of at least 20 percent of the emissions of $NO_x$ and at least 20 percent of the emissions of either $SO_2$ or Hg released when burning the refined coal (excluding any dilution caused by materials combined or added during the production process), as compared to the emissions released when burning the feedstock coal or comparable coal predominantly available in the marketplace as of January 1, 2003.

Section 45(d)(8) of the Code generally provides that the term "refined coal production facility" means a facility which is placed in service after October 22, 2004 and before January 1, 2012. Sections 4.07 and 5.02 of the Notice provide that when a facility is placed in service is determined in accordance with § 1.46-3(d) of the regulations.

Section 5.01 of the Notice provides that the refined coal credit is allowed for qualified refined coal produced and sold to an unrelated person by the taxpayer, without regard to whether the taxpayer owns the refined coal production facility in which the refined coal is produced. Accordingly, a taxpayer that leases or operates a facility owned by another person may claim the credit for refined coal that the taxpayer produces in the facility.

Section 5.02 of the Notice provides that a refined coal production facility will not be considered to have been placed in service after October 22, 2004, if more than 20 percent of the total fair market value of the facility (the cost of the new property plus the value of the used property) is attributable to property that was placed in service on or before October 22, 2004.

Section 6.01 of the Notice generally provides that a qualified emissions reduction does not include any reduction attributable to mining processes or processes that would be treated as mining (as defined in § 613(c)(2), (3), (4)(A), (4)(C), or (4)(I) of the Code) if performed by the mine owner or operator. Accordingly, in determining whether a qualified emission reduction has been achieved, the emissions released when burning the refined coal must be compared to the emissions that would be released when burning the feedstock coal. Feedstock coal is the product resulting from processes that are treated as mining and are actually applied by a taxpayer in any part of the taxpayer's process of producing refined coal from coal.

Section 613(c)(5) of the Code describes treatment processes that are not considered as mining unless they are provided for in § 613(c)(4) or any necessary or incidental to a process provided for in § 613(c)(4). Any cleaning process, such as a process that uses ash separation, dewatering, scrubbing though a centrifugal pump, spiral concentration, gravity concentration, flotation, application of liquid hydrocarbons or alcohol to the surface of the fuel particles or to the feed slurry provided such cleaning does not change the physical or chemical structure of the coal, and drying to removed free water, provided such drying does not change the physical or chemical identity of the coal, will be considered as mining.

Section 6.03(1) of the Notice provides, in part, that emissions reduction may be determined using continuous emission monitoring system (CEMS) field testing. Section 6.03(1)(a) provides, in part, that CEMS field testing is testing that meets all the following requirements: (i) The boiler used to conduct the test is coal-fired and steam-producing and is of a size and type commonly used in commercial operations. (ii) Emissions are measured using a CEMS. (iii) If EPA has promulgated a performance standard that applies at the time of the test to the pollutant emission being measured, the CEMS must conform to that standard. (iv) Emissions for both the feedstock coal and the refined coal are measured at the same operating conditions and over a period of at least 3 hours during which the boiler is operating at a steady state at least 90 percent of full load. (v) a qualified individual verifies the test results in a manner that satisfies the requirement of section 6.03(1)(b).

Section 6.03(2) of the Notice provides that methods other than CEMS field testing may be used to determine the emissions reduction. If a method other than CEMS field testing is used, the Service may require the taxpayer to provide additional proof that the emission reduction has been achieved. The permissible methods include (a) testing using a demonstration pilot-scale combustion furnace if it established that the method accurately measures the emission reduction that would be achieved in a boiler described in section 6.03(a)(a)(i) and a qualified individual verifies the test results in a manner that satisfies the requirements of section 6.03(1)(c)(i), (ii), (v), and (vi); (b) a laboratory analysis of the feedstock coal and the refined coal that complies with a currently applicable EPA or ASTM standard and is permitted under section 6.03(2)(b)(i) or (ii).

Section 6.04(1) of the Notice provides that a taxpayer may establish that a qualified emission reduction determined under section 6.03 applies to production from a facility by a determination or redetermination that is valid at the time the production occurs. A determination or redetermination is valid for the period beginning on the date of the determination or redetermination and ending with the occurrence of the earliest of the following events: (i) the lapse of six months from the date of such determination or redetermination; (ii) a change in the source or rank of feedstock coal that occurs after the date of such determination or (iii) a change in the process of producing refined coal from the feedstock coal that occurs after the date of such determination or redetermination.

Section 6.04(2) of the Notice provides that in the case of a redetermination required because of a change in the process of producing refined coal from the feedstock coal, the redetermination required under section 6.04 must use a method that meets the requirements of section 6.03. In any other case, the redetermination requirement may be satisfied by laboratory analysis establishing that – (a) the sulfur (S) or Hg content of the amount of refined coal necessary to produce an amount of useful energy has been reduced by at least 20 percent (40 percent, in the case of facilities placed in service after December 31, 2008) in comparison to the S or Hg content of the amount of feedstock coal necessary to produce the same amount of useful energy, excluding any dilution caused by materials combined or added during the production process; (b) the S or Hg content of both the feedstock coal and the refined coal do not vary by more than 10 percent from the S and Hg content of the feedstock coal and refined coal used in the most recent determination that meets the requirements of the Notice.

Finally, section 6.05 of the Notice provides that the certification requirement of section 3.01(1)(c) is satisfied with respect to fuel for which the refined coal credit is claimed only if the taxpayer attached to its tax return on which the credit is claimed a certification that contains the following: (a) a statement that the fuel will result in a qualified emissions reduction when used in the production of steam; (b) a statement indicating whether CEMS field testing was used to determine the emissions reduction; (3) if CEMS field testing was not used to determine the emissions reduction, a description of the method used; (4) a statement that the emissions reduction was determined or redetermined within the six months preceding the production of the fuel and that there have been no changes in the source or rank of feedstock coal used or in the process of producing refined coal from the feedstock coal since the emissions reduction was determined or was most recently determined; and (5) a declaration signed by the taxpayer in the following form: “Under penalties of perjury, I declare that I have examined this certification and to the best of my knowledge and belief, it is true, correct, and complete.”

With respect to the first two issues, the Process involves blending coal with the Chemical Reagents in a cyclone coal-fired boiler. Section 6.01 of the Notice provides generally that a qualified emission reduction does not include any reduction attributable to mining processes or processes that would be treated as mining, as further defined in the Code, if performed by the mine owner or operator. Section 613(c)(5) of the Code describes certain treatment processes that are not considered as mining unless they are provided for in § 613(c)(4) or are necessary or incidental to a process provide for in § 613(c)(4). For example, § 6.01(2) provides, in part, that any cleaning process such as the application of liquid hydrocarbons or alcohol to the surface of the fuel particle or to the feed slurry, provided such cleaning does not change the physical or chemical structure of the coal, will be considered mining. In the instant case, Process is not a mining process. Further, section 3.01 clarifies § 45(c)(7) and specifically provides that refined coal includes feedstock coal mixed with an additive or additives. Thus, additive processes which mix certain chemicals or other additives with the coal in order to achieve emission reductions may qualify for the production tax credit for refined coal. Accordingly, we conclude that (a) refined coal produced at the Facility using the Process and the Chemical Reagents is "refined coal" within the meaning of § 45(c)(7), provided the refined coal (i) is sold to an unrelated person within the meaning of § 45(c)(7) and (ii) meets the emission reduction requirement of § 45(c)(7)(B); and (b) an increase in the rate of application of a Chemical Reagent per ton of feedstock coal refined is not considered a "change in the process of producing refined coal from feedstock coal" for purposes of section 6.04 of Notice 2010-54

With respect to the third issue, the placed-in-service language in § 45(d)(8) focuses on the facility, and does not, by its terms, require the facility to have been placed in service by the taxpayer claiming the credit. Section 5.01 of the Notice provides that the refined coal credit is allowed for qualified refined coal produced and sold to an unrelated person by the taxpayer, without regard to whether the taxpayer owns the refined coal production facility in which the refined coal is produced. Therefore, a taxpayer that leases or operates a facility owned by another person may claim the credit for refined coal that the taxpayer produces in the facility. Accordingly, we conclude that the lease of the Facility subsequent to its placed-in-service date will not affect the placed-in-service date of the Facility for purposes of § 45 and will not affect the determination of whether the lessee is eligible for production tax credits for refined coal produced at the Facility.

With respect to the fourth issue, § 45(d)(8) generally provides that a "refined coal production facility" means a facility for the production of refined coal that was placed in service after October 22, 2004, and before January 1, 2012. Section 5.02 of the Notice 2010-54 provides that when a facility is placed in service is determined in accordance with § 1.46-3(d) of the regulations. In addition, section 5.02 provides that a refined coal production facility will not be considered to have been placed in service after October 22, 2004 if more than 20 percent of the total fair market value of the facility (the cost of the new property plus the value of the used property) is attributable to property that was

placed in service on or before October 22, 2004. This rule provides a test for determining whether modifications to a facility will result in a new placed in service date. Accordingly, we conclude that If the Facility was "placed in service" prior to January 1, 2012 within the meaning of § 45(d)(8)(B) of the Code, any subsequent modification or relocation of the Facility will not result in a new placed-in-service date for that Facility for purposes of § 45, provided the fair market value of the original property of the Facility is more than 20 percent of the Facility's total fair market value at that time.

With respect to the fifth issue, Taxpayer anticipates that it will continue to use CEMS field testing to determine and redetermine the qualified emission reduction from burning refined coal produced in the Facility. In general, Taxpayer anticipates that it will conduct a single CEMS field test every six months using refined coal produced from Blended Coal (Test Blend) containing 95% Location a coal and 5% Location b coal. However, it may decide to conduct emissions testing using refined coal produced from Blended Coal with a lower percentage of Location a coal. Taxpayer will treat Blended Coals as comparable coal if the percentage of Location a coal in the Blended Coal is within 5 percentage points of the percentage of Location a coal in the Test Blend (Test Blend Range). For example, if Taxpayer conducts emissions testing using a Set Blend containing 95% Location a coal and 5% location b coal, Blended Coals containing between 90% Location a coal and 100% Location b coal will be treated as comparable coals. If Taxpayer decides to begin producing refined coal from Blended Coal that is outside the Test Blend Range, Taxpayer will conduct additional CEMS field testing.

Thus, provided that the average of the Location a coal content and the Location b content of the Blended Coal used to produce refined coal at the Facility remains within 5 percentage points above or below the percentage of Location a coal in a Test Blend over a period of up to six months since the most recent determination test or redetermination test, Taxpayer should not be required to conduct redetermination testing based on a change in the source or rank of the feedstock coal. In other words, if Taxpayer conducts CEMS field testing using refined coal produced from Blended Coal containing 95% Location a coal, it should not be required to conduct redetermination testing before the expiration of six months unless the Location a coal content of the Blended Coal is reduced below 90%. Accordingly, we conclude that all feedstock coals that are Blended Coals with a Location a content of +/-5% of the Location a coal content of a Test Blend shall be treated as feedstock coals of the same source and rank as the Test Blend for purposes of section 6.04 of Notice 2010-54 regardless of the mine from which such feedstock is purchased.

This ruling expresses no opinion about any issue not specifically addressed in this ruling letter, including (1) whether any person has sold refined coal to an unrelated person, or (2) when the facility was "placed in service." In particular, we express or imply no opinion that the Taxpayer has sufficient risks and rewards of the production activity to qualify as the producer of the refined coal. The Service may challenge an attempt to transfer the credit to a taxpayer who does not qualify as a producer, including transfers structured as partnerships, sales or leases that do not also transfer sufficient risks and rewards of the production activity.

In accordance with the Power of Attorney on file with this office, we are sending a copy of this letter to your authorized representatives. A copy of this ruling must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

This ruling is directed only to the Taxpayer who requested it. Section 6110(k)(3) of the Code provides it may not be used or cited as precedent. We are sending a copy of this letter ruling to the Industry Director.

Sincerely,

Peter C. Friedman
Senior Technician Reviewer, Branch 6
Office of Associate Chief Counsel (Passthroughs & Special Industries)